

STITES & HARBISON PLLC

ATTORNEYS

421 West Main Street
Post Office Box 634
Frankfort, KY 40602-0634
[502] 223-3477
[502] 223-4124 Fax
www.stites.com

RECEIVED

November 9, 2009

NOV 09 2009

PUBLIC SERVICE
COMMISSION

Jeff R. Derouen
Executive Director
Public Service Commission
211 Sower Boulevard
P.O. Box 615
Frankfort, KY 40602-0615

Mark R. Overstreet
(502) 209-1219
(502) 223-4387 FAX
moverstreet@stites.com

RE: Case No. 2009-00316

Dear Mr. Derouen

Enclosed please find and accept for filing the original and ten copies of Kentucky Power Company's responses to the Staff's Supplemental Data Requests from the October 28, 2009 Informal Conference.

Copies of the responses are being served on counsel for the Kentucky Industrial Utility Customers, Inc. and the Attorney General.

Very truly yours,
Mark R. Overstreet

cc: Dennis G. Howard, II
Michael L. Kurtz

**COMMONWEALTH OF KENTUCKY
BEFORE THE
PUBLIC SERVICE COMMISSION OF KENTUCKY**

IN THE MATTER OF:

AN EXAMINATION BY THE PUBLIC SERIVCE)	
COMMISSION OF THE ENVIRONMENTAL)	
SURCHARGE MECHANISM OF KENTUCKY)	CASE NO. 2009-00316
POWER COMPANY FOR THE TWO YEAR)	
BILLING PERIOD ENDING JUNE 30, 2009)	

KENTUCKY POWER COMPANY

**RESPONSES TO COMMISSION STAFF'S OCTOBER 28, 2009
INFORMAL CONFERENCE DATA REQUESTS**

November 9, 2009

VERIFICATION

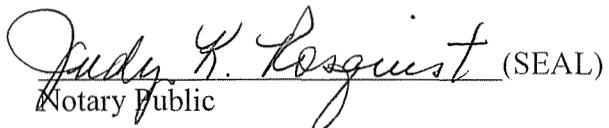
COMMONWEALTH OF KENTUCKY)
COUNTY OF FRANKLIN) CASE NO. 2009-00316

The undersigned, **Errol Wagner**, being duly sworn, states he is the Director of Regulatory Services for Kentucky Power Company, that he has personal knowledge of the matters set forth in the Data Responses for which he is identified as the witness, and the answers contained therein are true and correct to the best of his information, knowledge and belief.



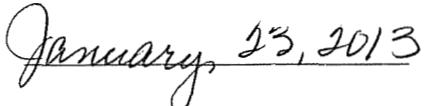
ERROL K. WAGNER

Subscribed and sworn to before me, a Notary Public in and before said County and State, this 5th day of November 2009.



Judy K. Losquist (SEAL)
Notary Public

My Commission Expires:



Kentucky Power Company

REQUEST

Please refer to the Company's response to the Commission Staff Informal Conference data requests dated October 7, 2009 Item No. 1, on page 5 of 22. Please provide the formula used to calculate the Weighted Average Borrowed Interest Rate for the Short Term Debt.

RESPONSE

The formula used to calculate the Weighted Average Borrowed Interest Rate for the Short Term Debt on page 5 of 22 is ((The Daily Short Term Borrowed Balance/ the Sum total for all daily Balances during the selected time period) X the corresponding daily Borrowed Interest Rate). The result is the Weighted Average Borrowed Interest Rate also for the given day.

For example, for May 1, 2008 the Short Term Borrowed Balance of \$37,719,817.39 is divided by \$34,803,612,298.49 and the result is 0.00108379. Then the result of 0.00108379 is multiplied by the Borrowed Interest Rate for May 1, 2008 of 3.11% to yield the Weighted Average Borrowed Interest Rate of 0.003375%.

WITNESS: Errol K Wagner

Kentucky Power Company

REQUEST

Please refer to the Company's response to the Commission Staff Informal Conference data requests dated October 7, 2009 Item No. 1, on page 5 of 22. Please explain why the short term borrowed balance column continues to change on the weekends?

RESPONSE

The reason the Short Term Borrowed Balance on page 5 of 22 continues to change on the weekends is that it is the daily accrued interest amount.

For example looking at Friday May 30, 2008, the Short Term Borrowed Balance is \$41,663,308.18 and the annual interest rate is 2.9148025% (2.91% rounded). Taking the Short Term Borrowed Balance of \$41,663,308.18 times the annual interest rate of 2.9148025% and dividing that result by 360 days result in a daily interest expense of \$3,373.59. The borrowed balance for Friday May 30, 2008 of \$41,666,308.18 plus the interest expense of \$3,373.59 results in a Saturday May 31, 2008 Short Term Borrowed Balance of \$41,669,681.77.

Taking the Saturday May 31, 2008, Short Term Balance of \$41,669,681.77 times the annual interest rate of 2.9148025 and dividing that result by 360 days results in a daily interest expense of \$3,373.86. The borrowed balance for Saturday May 31, 2008 of \$41,669,681.77 plus the interest expense of \$3,373.86 results in a Sunday June 1, 2008 Short Term Borrowed Balance of \$41,673,055.63

WITNESS: Errol K Wagner

Kentucky Power Company

REQUEST

Please refer to the Company's response to the Commission Staff Informal Conference data requests dated October 7, 2009 Item No. 1, on pages 13 through 22 of 22 (Accounts Receivable Financing).

(a) There is no carrying cost charge for the weekend balances. Why did the methodology appear to change from the Company last environmental surcharge Case No. 2009-00038 where daily carrying cost charges were imposed for weekend balances?

(b) When comparing the Daily Carrying Cost Charge rate column in Case No 2009-00316 versus Case No. 2009-00038 the rate appears to be more volatile. Please give the reasons for the rate volatility.

RESPONSE

(a) Kentucky Power factors its accounts receivable as a low-cost means of financing. The Company sells its accounts receivable each working day to AEP Credit, which in turns sells the accounts receivable into the asset backed commercial paper market. The cost of this type of financing is taken as a deduction from the face value of the accounts receivable when purchased by AEP Credit. For example, Kentucky Power may receive \$999.98 for each \$1,000.00 of accounts receivable. This deduction, which represents the cost of financing over the period the accounts receivable are repaid, is calculated as follows: (the value of the accounts receivable factored that day) X (AEP Credit's weighted daily cost of capital) X (the projected period of time, based on past experience, over which the bills underlying the accounts receivable will be paid). Of course, the bills underlying the accounts receivable may be repaid over a period different than estimated by AEP Credit at the time it purchased the accounts receivable.

Until early 2008, Kentucky Power "trued up" the financing cost for each period's accounts receivable to reflect AEP Credit's actual cost of financing for the period over which the bills underlying the accounts receivable financed. This trued-up cost would be allocated to each calendar day (including non-working days when Kentucky Power did not sell its accounts receivable) during the applicable period.

To sell the accounts receivable into the open market (the ultimate source of the financing) the purchase agreement between AEP Credit and Kentucky Power requires a "True Sale Opinion." The True Sale Opinion is legal opinion from independent counsel that the sale of accounts receivable by Kentucky Power to AEP Credit is a true sale whereby Kentucky Power divests itself of all interest in the accounts receivable. In early 2008, independent counsel concluded it could not deliver a True Sale Opinion if Kentucky Power and AEP Credit trued up the financing costs as it previously did. Rather, the opinion required that the capital cost charges be calculated at the time of each A/R purchase, which occurs only on business days. Thereafter, in conformity with the opinion, Kentucky Power and AEP Credit no longer trued up the cost of financing.

It is important to keep in mind that both before and after the new True Sale Opinion Kentucky Power factored its accounts receivable to AEP only on regular business days. The only difference is that after the True Sales Opinion Kentucky Power and AEP Credit no longer true up the costs. Rather, the credit cost charges are calculated at the time of the sales, which do not occur on weekends or holidays.

The response to the data request in Case No. 2009-00038 was prepared using the former method whereby the daily capital cost charges were calculated using AEP Credit's daily cost of capital multiplied by the outstanding A/R balance, including weekend balances. The response (pages 13 to 20 of 22 of the Company's response to Item 4) in this proceeding (Case No. 2009-00316) was prepared in conformity with the requirements of the new True Sales Opinion and thus does not show charges for weekends and holiday when no sales take place. Instead, the cost for the entire period over which the accounts receivable are expected to be repaid (including weekends and holidays) is calculated on the day the accounts receivable are factored. That cost is recorded on KPCo's books as the cost of factoring its accounts receivable.

(b) The Company has developed a 6 page attachment to this response to aid the Commission in following the explanation below.

The apparent volatility is a result of the daily differences in the amount of accounts receivable factored each day. By way of example, that amount can vary from approximately \$860,000 on April 7, 2008 to approximately \$8.4 million on August 4, 2008. (See page 4, Column D of 9 and page 5 Column D of 9.) Under the former True Sales Opinion the amount of accounts receivable factored on any day did not directly affect the calculation of the daily cost of capital. Under the new True Sales Opinion the amount of accounts receivable factored is an independent variable in the calculation of Kentucky Power's "carrying cost charge" and ultimately its "daily carrying cost charge." Large changes in the amount of the accounts receivable factored will lead to significant changes in the "daily carrying cost charge."

As reported in this case (2009-00316), the "daily carrying cost charge" (pages 13 to 20 of 22 of the Company's response to Item 4) is the weighted rate paid by Kentucky Power to factor the accounts receivable on any particular date. It is calculated by dividing Kentucky Power's actual carrying cost for the day in question by the accounts receivable balance as of the same day. As explained in the answer to subpart (a) of this data request, Kentucky Power's actual carrying cost

KPSC Case No. 2009-00316
Commission Staff's Data Requests
October 28, 2009 Informal Conference
Item No. 3
Page 3 of 9

for the day in question is calculated by multiplying the Company's daily cost of capital by the previous month's average days outstanding and multiplying that product by the amount of accounts receivable factored on that day.

As reported in Kentucky Power's immediately preceding case (2009-00038), the "daily carrying cost charge" was AEP Credit's internal cost of capital. It was the "trued up" cost referred to in the response to subpart (a) of this data request.

The difference in manner in which the "carrying cost charge," which affects the "daily carrying cost charge," was calculated, and the effect of changes in the amount of accounts receivable factored, is illustrated by comparing the lines for April 1, 2008 and April 2, 2008 on page 4 of 9 of this response.

On April 1, 2008, AEP Credit's internal cost of credit (column ("b")), which was reported as the "carrying cost charge" in Case No. 2009-00038, was 0.00011. It can be calculated by dividing the daily carrying cost charge for April 1, 2008 (the trued up amount by which the accounts receivable that were factored that day were discounted) (column "c"), by Kentucky Power's accounts receivable balance (column "a").

For April 1, 2008, Kentucky Power's "carrying cost charge" calculated in accordance with the new True Sales Opinion would be computed by multiplying AEP Credit's internal cost of credit for the date (the same 0.00011 reported in Case No. 2009-00038), times the estimated number of days required of the accounts receivable to be paid (column ("f")), times the accounts receivable factored on date (column ("j")), to yield the "carrying cost charge" (labeled "KP actual carrying cost incurred"). This carrying cost charge is then divided by Kentucky Power's accounts receivable balance that day (column (a)) to yield the "actual cost of capital as a percentage of the accounts receivable balance (column ("j"))). This amount was reported in Case No. 2009-00316 as the "daily carrying cost charge."

The effect of daily differences in the amount of accounts receivable factored on the "daily carrying cost charge" is illustrated by comparing the computed charges for April 1, 2008 and April 2, 2008. On April 1, 2008 AEP Credit's internal cost of capital was 0.00011. On April, 2, 2008, that cost was 0.000107. These were the figures reported as the "daily carrying cost charge" in Case No. 2009-00038.

On those same two days, Kentucky Power factored \$2.977 million and \$7.596 million in accounts receivable. This led to carrying cost charges of \$10,726.98 and \$26,619.40 on those days (and daily carrying cost charges of 0.00027 and 0.000584) even though the internal cost of capital only changed slightly from 0.00011 to 0.000107 between those two days.

WITNESS: Errol K Wagner

Kentucky Power Company

REQUEST

Please refer to the Company's response to the Commission Staff Informal Conference data requests dated October 7, 2009 Item No. 1, page 22 of 22. In light of your response to Data Request No. 3 is the average annual carrying cost rate properly calculated? If so, please explain the methodology and theory underlying the calculations.

RESPONSE

Yes, the average annual carrying cost rate is properly calculated. The long-term debt, short-term debt and the common equity methods of calculating the carrying costs for KPCo have not changed. Only the Accounts Receivable Financing methodology changed due to the change in the True Sales Opinion as discussed in the Company's response to Item No. 3.

The new methodology for calculating the Account Receivable Financing is as follows, the daily cost of capital is multiplied by the previous month's average days the factored accounts receivable were outstanding, to arrive at the discount factor. The discount factor is multiplied by the daily amount of account receivables to be factored, to arrive at KPCo's actual carrying cost incurred in dollars. KPCo's actual carrying cost incurred in dollars is then divided by the daily account receivable balance, to arrive at the actual cost of capital as a percent of the daily account receivable balance. The reason there are zeros for Saturday, Sundays and Holidays is that account receivables are not factored on those days. The cost of carrying the accounts receivable balances on the weekends and holidays is a part of the cost incurred each time the accounts receivable are factored. Mathematically the cost of the weekends and holidays is made part of the overall cost by multiplying the expected number of days the accounts receivable will remain outstanding (calculated by using the previous month's average days the accounts receivable were outstanding), which would include weekends and holidays, by the daily cost of capital.

WITNESS: Errol K Wagner

Kentucky Power Company

REQUEST

Please provide the schedules included in the Company's response to the Commission Staff Informal Conference data requests dated October 7, 2009 Item No. 1 (pages 5-20 of 22) in electronic format.

RESPONSE

Please see the CD attached.

WITNESS: Errol K Wagner